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**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER G-75-10**

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IN THE MATTER OF  
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473, as amended  
and  
the Insurance Corporation Act, R.S.B.C. 1996, Chapter 228, as amended  
and

A Filing by the Insurance Corporation of British Columbia  
on the Report on Finding from the Independent Third Party Review of  
ICBC's Regional Claim Centres Financial Allocation and  
Specified Financial Allocation Functions

**BEFORE:** A.W.K. Anderson, Commissioner  
D.A. Cote, Commissioner

April 22, 2010

**O R D E R**

**WHEREAS:**

- A. On November 26, 2009 Navigant Consulting Inc. (Navigant) filed with the British Columbia Utilities Commission (Commission) and the Insurance Corporation of British Columbia (ICBC) its "Report on Findings from the Independent Third Party Review of ICBC's Regional Claim Centres Financial Allocation and Specified Financial Allocation Functions" (ITP Report or Navigant Report). Navigant provided recommendations in its ITP Report that included a more detailed study in the near future to determine work effort percentages; and
- B. Navigant was the chosen Independent Third Party (ITP) following the Expression of Interest issued by ICBC. The ITP followed the Revised Terms of Reference dated February 20, 2009 as approved by Order G-31-09; and
- C. By letter dated December 23, 2009, the Commission set out a process for letters of comments from past interveners and ICBC on the analysis, findings and recommendations contained in the Navigant Report; and
- D. On January 13, 2010, the Insurance Bureau of Canada provided its comment on the Navigant Report. Subsequently, on January 29, 2010, ICBC provided its reply submission; and
- E. The Commission has reviewed the Navigant Report and the comments received.

**NOW THEREFORE** the Commission orders as follows:

- 1. ICBC is directed to implement the Independent Third Party Report recommendations, subject to any adjustments contained in the Reasons for Decision attached as Appendix A to this Order.

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2. ICBC is directed to provide a progress report to the Commission on the detailed work effort study by March 15, 2011.
3. ICBC is directed to file the detailed work effort study by September 1, 2011. Thereafter, an update of the detailed study is to be filed within 24 months of a Commission Decision on that filing. In addition, another detailed study is to be filed when significant business changes occur or, at minimum, within 5 years from September 1, 2011.

**DATED** at the City of Vancouver, in the Province of British Columbia, this            30<sup>th</sup>            day of April 2010.

BY ORDER

*Original signed by:*

A.W.K. Anderson  
Commissioner

Attachment



## **IN THE MATTER OF**

### **A FILING BY THE INSURANCE CORPORATION OF BRITISH COLUMBIA ON THE REPORT ON FINDINGS FROM THE INDEPENDENT THIRD PARTY REVIEW OF ICBC'S REGIONAL CLAIM CENTRES FINANCIAL ALLOCATION AND SPECIFIED FINANCIAL ALLOCATION FUNCTIONS**

## **REASONS FOR DECISION**

**April 22, 2010**

#### **BEFORE:**

A.W.K. Anderson, Commissioner  
D.A. Cote, Commissioner

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### **APPENDIX 1: INDEPENDENT THIRD PARTY REPORT**

## **1.0 INTRODUCTION**

This Reasons for Decision records the Commission's findings and determinations with regards to the Independent Third Party (ITP) Report arising from Commission Order G-31-09 that approved the Terms of Reference for an ITP Review of Regional Claim Centres Allocation and Specified Allocation Functions.

### **1.1 The Filing**

In its reply submission dated January 29, 2010, the Insurance Corporation of British Columbia (ICBC) proposes to start the work for a detailed work effort study as outlined in the ITP Report, including the process of retaining an independent third party in Fall 2010 and completing the detailed work effort study with the Commission by Summer 2011.

### **1.2 Background**

ICBC operates three lines of business in one integrated operation: Basic Insurance, Optional Insurance, and Non-Insurance. The Commission regulates Basic Insurance only, and therefore, ICBC must allocate its joint costs between the three lines of business to avoid cross-subsidization between the regulated (Basic Insurance and Non-Insurance) and non-regulated (Optional Insurance) operations. Fortunately, the bulk of ICBC's costs can be directly allocated to Basic Insurance or Optional Insurance. However, the joint costs that are not directly attributable to each line of business requires an allocation methodology to fairly and efficiently allocate these costs.

Prior to regulation in 2002, ICBC completed a transaction costing model, which determined eleven transaction types, five job categories and the original work effort percentages. In 2003 the transaction costing study was adopted as the basis for the Regional Claim Centres (RCC) cost allocation methodology including ten (not eleven) transaction types.

In 2003, 2004, and 2007 the work effort percentages were updated to reflect business changes. In 2006/2007, ICBC undertook a major review of its RCC work effort study model and methodology, which was filed with the Commission in late 2007 (the 2007 Work Effort Study).

In February 2008, ICBC and most interveners achieved a negotiated settlement of the RCC allocations. Commission Order G-73-08 approved the negotiated settlement and directed ICBC to prepare and file an application for approval of a Proposal Plan for the identification and selection of an ITP to review report on and make recommendations with respect to ICBC's financial allocation methodology.

On October 31, 2008, ICBC filed its Proposal Plan for an ITP Review. Commission Order G-167-08 established a workshop for interveners to review the Proposal Plan. Following the workshop process and intervenor submissions, ICBC amended its

Proposal Plan and by Order G-31-09, dated March 26, 2009 the Commission approved a terms of reference for an ITP Review of Regional Claims Centres Allocation (RCCA) and Specified allocation functions (Terms of Reference).

Navigant Consulting Inc. (Navigant) was retained to undertake the ITP Review. Navigant filed its "Report on Findings from the Independent Third Party Review of ICBC's Regional Claim Centres Financial Allocation and Specified Financial Allocation Functions" (ITP Report or Navigant Report) on November 26, 2009, attached as Appendix 1. The ITP Report includes Navigant's analysis, findings and recommendations.

### **1.3 Comment Process**

By letter dated December 23, 2009, the Commission invited comments on the ITP Report from past interveners and also provided an opportunity for ICBC to comment on the ITP Report and reply to any intervener comments. The Insurance Bureau of Canada (IBC) was the only intervener that provided comments in its submission dated January 13, 2010. ICBC provided its reply submission on January 29, 2010.

In its submission, IBC states that it can neither agree with nor endorse the ITP Report. IBC submits that the ITP Report does not address its concerns with respect to the 2008 Negotiated Settlement and that the Commission directed process is flawed by setting terms of reference that are too narrow. However, IBC did provide some comments on the recommendations contained in the ITP Report.

ICBC in its submission supports the ITP's primary finding that the 2007 updated Work Effort Study results in a fair and equitable allocation of regional claim centre costs between Basic Insurance and Optional Insurance (ITP Report, p. 8). ICBC generally supports the Navigant recommendations regarding the approach for determining work effort percentages, however, ICBC does take issue with some of the ITP Report recommendations.

## **2.0 INDEPENDENT THIRD PARTY REVIEW**

### **2.1 The Approach**

Navigant performed an independent validation of the regional claim centre's cost allocation methodology in accordance with the Terms of Reference set out by the Commission (ITP Report, Appendix B). In coming to its conclusions, Navigant reviewed previous filings to the Commission and the history behind the work effort studies and conducted interviews with 15 individuals that participated in the 2007 Work Effort Study.

### **2.2 The Findings**

Navigant outlines its various findings in section 2.0 Summary of Findings (ITP Report, pp. 2-3). Navigant concludes that the 2007 Work Effort Study results in a fair and equitable allocation of RCC costs between Basic Insurance and Optional

Insurance and is “conceptually consistent with the state of the art embedded cost studies” (ITP Report, p. 14). Navigant is of the opinion that the data supplied and utilized in the 2007 Work Effort Study was reasonable, appropriate and of the same nature typically used in transaction costing exercises. Navigant notes that the 2007 Work Effort Study resulted in 66 changes to the work effort percentages which were reasonable, and that the 2007 revisions reflect the evolving mix of employees and the changes to their duties (ITP Report, pp. 2-3).

### **2.3 The Ten Transaction Types for Regional Claim Centres**

Navigant reviewed ten RCC transaction types: six for Material Damage (MD) Files and four for Bodily Injury (BI) Exposures. Five of the ten transaction types (MD – Glass, MD Files – Comprehensive Total Theft, MD Files – Comprehensive Other, BI Exposures – Low Velocity Impact, and BI Exposures – Non Represented) can be directly allocated. The remaining five transaction types are indirectly allocated to Basic Insurance and Optional Insurance based on work effort and other proxies. Table 1 lists the ten transaction types.

**Table 1: The Ten Transaction Types and Allocation Method**

<b>Transaction Type</b>	<b>Allocation Method</b>
1. MD Files –Glass	Direct Allocation
2. MD Files –Customer Care	Indirect Allocation
3. MD Files –Collision/Property Damage	Indirect Allocation
4. MD Files –Comprehensive Total Theft	Direct Allocation
5. MD Files –Comprehensive Other	Direct Allocation
6. MD Files –Other	Indirect Allocation
7. BI Exposures – Low Velocity Impact	Direct Allocation
8. BI Exposures – Non Represented	Direct Allocation
9. BI Exposures – Represented	Indirect Allocation
10. BI Exposures – Litigated	Indirect Allocation

Navigant found that the data supplied and utilized in the 2007 Work Effort Study was reasonable. Since the directly allocated transactions types are based on the underlying data, these directly allocated transaction types will not be discussed further. However, the five indirectly allocated transaction types are discussed in the following section.

### **2.4 Proxies for the Five Transaction Types with Indirect Allocation**

The five transaction types with an indirect allocation to Basic and Optional Insurance are discussed further in the following order: BI Exposures – Represented, BI Exposures – Litigated, MD Files – Collision/Property Damage, MD Files – Customer Care, and MD Files – Other.

#### **2.4.1 Transaction Types: Bodily Injury Exposures – Represented and Bodily Injury Exposures – Litigated**

Navigant noted that in 2006 only 0.17 percent of bodily injury exposures settled by RCC were above the \$200,000 Basic Insurance limit. An additional 2.1 percent of BI claims were transferred to head office, anticipating the claim would exceed \$200,000. Navigant finds that the 5 percent allocation to Optional Insurance is reasonable, given that only a small number of claims are above the Basic Insurance limit and that the majority of work performed by RCC is spent handling the primary portion of these claims under Basic Insurance. Navigant recommends that in future, ICBC determine the number of claims that exceed \$200,000 and then double the percentage to determine work effort percentages.

Navigant was asked to comment on whether there is a need to allocate a portion of work effort for claims settling under \$200,000 to Optional Insurance. Navigant validates that there is no need to do so for bodily injury represented or litigated, since there is minimal to nil chance of exposure over the \$200,000 Basic Insurance limit. However, Navigant recommends that ICBC apply the same proxy and work effort methodology to these transactions as the ICBC methodology for BI Exposures – Represented and BI Exposures – Litigated settling over the \$200,000 Basic Insurance limit, where there is believed to be exposure over the \$200,000 limit or where the transaction type is being monitored or investigated for exposure, but ultimately settles below the \$200,000 limit.

#### **2.4.2 Transaction Type: Material Damage Files – Collision/Property Damage**

For MD Files – Collision/Property Damage claims, ICBC attributes costs directly to either Basic Insurance or Optional Insurance where the allocation is clear. In cases where liability is contentious and it is nearly impossible and/or too onerous to split, ICBC allocates costs equally between Basic Insurance and Optional insurance. Navigant finds this to be reasonable.

#### **2.4.3 Transaction Type: Material Damage Files – Customer Care**

ICBC applies file count as a proxy for purposes of allocating MD Files – Customer Care costs among Basic Insurance and Optional Insurance. In cases where liability is contentious and it is difficult to split the time spent, ICBC splits the claim count equally between Basic Insurance and Optional Insurance. Navigant finds this approach to be reasonable.

#### **2.4.4 Transaction Type: Material Damage Files – Other**

MD Files – Other relates to unidentified motorists involved in hit and run claims and uninsured motorists' property damage files. Navigant supports the current ICBC allocation based on hit-and-run claims recorded.



## **2.5 Specified Allocation Functions**

The Terms of Reference directs the ITP Reviewer to review four specific allocation functions: fraud management, call centre department, chief underwriter, and field broker support. Navigant's opinions on these specified allocation functions are as follows:

### **2.5.1 Fraud Management**

Navigant concludes that ICBC's approach of using the weighted average of the RCC's total claims and salvage Basic/Optional ratios as a proxy is reasonable.

### **2.5.2 Call Centre department**

Navigant concludes that using newly opened exposures/volume as the allocator for the call centre department is the "most realistic" measure, as newly opened exposures is a first reporting or claim intake function.

### **2.5.3 Chief Underwriter**

Navigant finds the ICBC allocation methodology using premiums written based solely on coverages with the exception of Professional Services and Other Operating budget to be the "most reasonable" approach for allocating the chief underwriter costs.

### **2.5.4 Field Broker Support**

ICBC uses work effort to allocate field broker support. Navigant concludes this is the "most reasonable" approach for allocating these costs.

## **2.6 Industry Practices**

Navigant notes that ICBC asserts in its filings to the Commission that its allocation methodology is consistent with generally accepted accounting principles, the U.S. National Association of Insurance Commissioners Issue Paper, Insurance Bureau of Canada Expense Allocation Program, and where appropriate the Public Automobile Insurance Industry of Canada. In addition, Navigant notes that the Pricewaterhouse Coopers, LLP (PWC) audit report dated March 5, 2009 states that PWC is of the opinion that ICBC is in compliance, in all material respects, with the criteria for attributing revenues and costs to Optional Insurance, Basic Insurance, and Non-Insurance.

Navigant reviewed the above principles/guidelines and the PWC report. Navigant agrees that the ICBC methodology is appropriate and in line with these guidelines.

### **3.0 INDEPENDENT THIRD PARTY RECOMMENDATIONS**

Navigant provided its recommendations in Section 7.0 Recommendations for Future Regional Claim Centre Work Effort Studies (ITP Report, pp. 15-17). In this Reasons for Decision, the Navigant recommendations have been grouped into four categories. The recommendations are summarized below along with any comment by ICBC and IBC.

#### **3.1 Proposed Approach to Determine Work Effort Percentages**

Given the focus shift and changes in ICBC's day to day business, Navigant recommends that a more detailed cost allocation study should be undertaken in the near future in a similar form to the 2002 Transaction Costing exercise. ICBC accepts this recommendation and proposes to start work on a detailed work effort study in Fall 2010 for completion by Summer 2011 (ICBC Reply Submission, p. 3).

#### **3.2 Updating, Oversight, and Transparency**

Navigant recommends that work effort percentages should be updated every 24 months and detailed studies should take place when significant business changes occur or at a minimum every 5 years. ICBC accepts this recommendation (ICBC Reply Submission, p. 2).

Navigant believes that Third Party oversight should occur for the entire process but at a minimum for the actual work effort study session. IBC in its submission appears to endorse this recommendation when it noted Navigant's recommendation on oversight and transparency (IBC Submission, p. 2). ICBC disagrees with the scope of Navigant's ITP recommendation. ICBC submits that the added ITP participation in the work effort study should be value-added, efficient, and balanced against the cost to Basic Insurance policyholders. ICBC proposes that the ITP attend the final meeting where the study group discusses and validates the work effort percentages of a detailed work effort study (ICBC Reply Submission, p. 2).

Navigant recommends that there should be more transparency in all aspects of the studies. ICBC responds that a detailed audit trail will be maintained (ICBC Reply Submission, p. 2).

#### **3.3 Proxy for Bodily Injury Exposures – Represented and Bodily Injury Exposures – Litigated**

Navigant recommends that ICBC should use the same type of proxy and work effort methodology as used for BI Exposures – Represented and BI Exposures – Litigated over \$200,000 for those claims which appear to have exposure over \$200,000 and are being monitored or investigated for excess exposure, but settle below \$200,000.

IBC states that there should be some recognition that the claims might have settled above \$200,000 (IBC Submission, p. 2). ICBC rejects this recommendation on the basis that the existing 5 percent allocation to Optional Insurance already includes a fair margin to account for the potential that adjusters consider that some claims may exceed the Basic Insurance policy limits. ICBC does not track files on this basis and claims there is no practical means of doing so (ICBC Reply Submission, p. 2).

### **3.4 General Administrative Time**

Navigant believes that general administrative time should be separately considered when determining work effort for the managerial group. Accordingly, Navigant recommends that there should be a separate transaction type for administrative work not related to one of the ten existing transaction types. ICBC believes that the existing ten transaction types should be retained to avoid unnecessary complexity in the model. ICBC submits that the addition of this transaction type has no material effect on the overall allocation, since administrative work is relatively narrow and the overall RCCA would be used to allocate the proposed transaction type (ICBC Reply Submission, p. 3).

## **4.0 COMMISSION DETERMINATIONS**

The Commission has reviewed the ITP Report and the submissions from IBC and ICBC. The Commission findings and determinations are below.

IBC in its submission disagrees with the ITP Report and considers its terms of reference as too narrow. The Commission has reviewed the Revised Terms of Reference dated February 20, 2009 approved by Order G-31-09. Order G-31-09 provides the scope of the ITP review that the Commission approved. The Commission finds that Navigant has conducted the ITP review in accordance with that Order.

Navigant found the proxies and cost allocation methodology to be appropriate. Also, Navigant concludes that ICBC follows industry practice in its cost allocation. Based on the Navigant findings, the Commission is satisfied the cost allocation methodology appropriately allocates costs to Basic Insurance and Optional Insurance.

Navigant recommends that a more detailed study should be conducted in the near future to determine work effort percentages that are fair and equitable and provide for a reasonable allocation of costs. Navigant proposes an approach to determine work effort percentages, updates every 24 months, third party oversight, and transparency and detailed documentation. The Commission agrees with these recommendations in principle. The Commission considers that updates provide assurance that the allocation percentages remain valid. Also, third party oversight provides assurance to

stakeholders and to the Commission that ICBC utilizes a proper and consistent methodology. The Commission further considers that transparency and detailed documentation allows future updates to be carried out in a consistent and reliable manner. **For these reasons, the Commission determines that a more detailed study should be conducted in the near future and that an ITP reviewer should be involved in the detailed study process.**

**The Commission directs ICBC to undertake the detailed work effort study with the ITP reviewer involved throughout the planning stage of the detailed study and during the study group meetings to finalize work effort and proxy allocations. The ICBC filing is to include a report from the ITP.**

Navigant recommends a further proxy method for BI – Represented and BI – Litigated as described in section 3.3 in this Reasons for Decision. The Commission must consider the cost of incurring additional work and the benefits accrued from that work. Presently, the BI Exposures – Represented and BI Exposures – Litigated is allocated 95 percent to Basic Insurance and 5 percent to Optional Insurance. As discussed in section 2.4.1 in this Reasons for Decision, this allocation on work effort already incorporates an additional margin of costs allocated to Optional Insurance. Recognizing this extra margin, the Commission does not believe that any further refined analysis would provide a sufficient justification to adjust the 5 percent allocation to Optional Insurance. Therefore, the Commission declines to implement Navigant’s recommendation on the additional proxy and work effort for BI Exposures – Represented and BI Exposures – Litigated.

Navigant recommends a separate transaction type for administrative work. The Commission finds that there is little added benefit to creating an eleventh transaction type for administrative work not related to one of the ten existing transaction types. The Commission is satisfied that since administrative work is already captured in the existing work effort allocation process, a further refinement would not justify the additional costs to add another transaction type. Therefore, the Commission declines to add an eleventh transaction type for administrative work.

The Commission agrees with both Navigant and ICBC that further work is required to undertake a detailed cost allocation study. Recognizing the extensive work that is required, the Commission accepts the proposed time line proposed by ICBC to complete the detailed work effort study with the Commission by Summer 2011.

**ICBC is directed to file the detailed work effort study by September 1, 2011. Thereafter, an update of the detailed study is to be filed within 24 months of a Commission Decision on that filing. In addition, another detailed study is to be filed when significant business changes occur or, at minimum, within 5 years from September 1, 2011.**